

Directions for Corporate Governance

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Acknowledgements

The author is grateful to a number of people for comments and suggestions on drafts of this paper, including Michael John Jones, Michael Mumford, Simon Norton and members of the ACCA Committee on Corporate Governance and Risk Management. I am especially grateful to Paul Moxey for his careful reading and editing of various drafts and for his continued support, both of this paper and of the British Accounting Association Special Interest Group on Corporate Governance and its activities. Thanks also to the speakers at the two symposia (the focus of this paper) for their comments on the draft, especially Brian Cheffins.

This paper has been reviewed by the ACCA Corporate Governance and Risk Management Committee, which exists to contribute to the improvement of knowledge and practice in corporate governance and risk management and to guide and shape ACCA's global strategies and policies in these areas. The Committee, chaired by Professor Andrew Chambers, comprises experts from business, the public sector, academia and the ACCA Council.

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Contents

Executive summary	5
1. Introduction	7
2. The background	8
3. Cutting-edge themes in corporate governance	10
4. Conclusions and an agenda for future research	24
References	27
Appendix 1: List of speakers	30
Appendix 2: Biographies	31

Executive summary

This paper summarises the content of two corporate governance symposia organised by the British Accounting Association Special Interest Group on Corporate Governance (BAASIGCG), setting them in the context of the existing body of corporate governance literature. The content of the presentations is then drawn on to establish the 'cutting edge' of corporate governance research, from a practitioner and academic perspective. This allows us to develop an informed agenda for future research in the corporate governance area. Specifically, the paper considers cutting-edge issues in corporate governance in relation to: a global convergence; risk; the European Union (EU); developing economies; institutional investors; audit; private equity; stakeholder accountability, and socially responsible investment (SRI).

One of the underlying objectives of BAASIGCG and of this paper, is to establish links between practitioners and academics in the field of corporate governance. Academic research must feed into the practitioner sphere if it is to be useful in achieving improvements in corporate governance. In the light of this objective, the paper provides a series of research questions, derived from the cutting-edge issues identified.

The symposia identified a need for further research into traditional, family-run/controlled listed companies and their attitudes towards voting rights. Given recent moves to consider implementing one-share: one-vote across EU member states it would be useful to explore the attitudes of company directors towards such changes in shareholder rights. In light of the European Commission's decision not to legislate on the one-share: one-vote principle, how can potential conflicts of interest between institutional shareholders and founding family shareholders be resolved? Further research could investigate the differential attitudes of founding family shareholders towards corporate governance reform across EU countries. Such work would inform policy makers in establishing further reform in the area of shareholder democracy.

Another area, also connected to shareholder democracy, where further research is required, is that of improving relationship investing by institutional investors. The report shows that there is emerging evidence indicating that international shareholder collaboration is occurring. However, further research could examine the extent to which this collaboration is genuinely succeeding in adding value for shareholders, as well as altering corporate behaviours. A further question is, how can corporate governance attention focus more on strategic issues relative to compliance?

Another important issue raised in the symposia was that of rebuilding trust in financial institutions. As discussed in this report, recent attempts to review accountability in financial institutions have revealed weaknesses (indeed, a vacuum) in the corporate governance of financial institutions. Research is needed which could attempt to identify ways in which institutional investors could improve their own governance structures.

A salient issue raised in the symposia was the apparently wide-ranging concerns about the audit function and its effectiveness. From the presentations we gleaned evidence of a significant lack of confidence in audit. It seems that researchers should be investigating how trust in audit quality may be rebuilt, as audit is the 'cornerstone' of good corporate governance. Further research is urgently required to assess how deeply rooted in the financial community is the concern about audit. Also, interview research could be used to assess whether or not there need to be further changes to auditors' liability. Another area where research appears necessary is examining the views of professional indemnity insurers on the consequences of changes to auditors' liability.

Several speakers discussed the 'comply or explain' approach to corporate governance which has been adopted by the EU. However, the suitability of this approach is not necessarily acknowledged. Further research could be conducted to assess whether or not a comply or explain environment is appropriate for all EU member states, which are so diverse in ownership structure, inter alia. Another research question arising from the symposia was whether or not the 'one size does not fit all' caption is actually being used as an excuse for not developing a Europe-wide set of principles. The Organisation for Economic Cooperation and Development (OECD) has produced a set of principles for countries that are far more diverse than those in the EU (OECD 2004). Therefore, researchers should be investigating the potential for an EU-wide code of best corporate governance practice. A problem which emerged from the discussions in the symposia was the lack of sanctions within the EU for non-compliance. Again, a fruitful area for policy-driven research would be to examine ways in which such sanctions could be strengthened. Other issues which represent important research questions relating to corporate governance in the EU are, for example, what the consensus is on an EU-wide language for accounts and documentation. At the moment, the diversity of language is acting as a barrier to corporate accountability between the member states. The problems of ensuring that EU companies have genuinely independent non-executive directors represent another area where research is required. These issues require research by the academic community which is closely tied into the practitioner community in order to inform pan-European policy on corporate governance.

The symposia discussed the problems relating to corporate governance reform in developing economies, using Uganda as a specific example. The problems identified in Ugandan corporate governance were generally believed to apply to many developing countries. The discussion raised a number of issues which could benefit from further research. For example, the question of how structural and cultural impediments to corporate governance reform may be reduced and/or removed. Cultural barriers such as tribalism and human rights problems associated with abuse of power within corporations were the types of problems identified in the symposia which require urgent attention by researchers.

The last major area covered by the symposia was that of stakeholder accountability. Speakers suggested that although stakeholder engagement was taking place the genuine accountability of these programmes could be questioned in many cases. Again, there is clearly a need for research which queries whether current stakeholder engagement programmes and sustainability reporting are adequate ways for business to discharge their accountability to stakeholders. Another fruitful area for researchers, emerging from the discussions, would be to identify potential new corporate governance mechanisms for enhancing stakeholder inclusivity. Current research has raised problems with stakeholder accountability but has done little to offer solutions.

Overall, we felt that the symposia had succeeded in summarising the current 'cutting edge' of corporate governance research. They had also succeeded in identifying a number of salient areas where further research is urgently required in order to advance reform and improve corporate governance and accountability in the UK, in the EU and in developing economies.

1. Introduction

This paper brings together the fruits of discussions at two ACCA-sponsored corporate governance symposia, organised by the British Accounting Association Corporate Interest Group on Governance Special (BAASIGCG). These symposia welcomed a series of speakers from both the academic and practitioner spheres. There were two principal aims of these events. First, the symposia aimed to identify the most pertinent emerging issues in corporate governance, with a view to establishing a future research agenda for academic and practitioner research. Second, the event aimed to provide a platform for high-level debate between practitioners and academics in the area of corporate governance, in order to forge links between academic and professional research.

The first symposium¹ focused on the role of shareholders and other stakeholders in corporate governance within a global context. The second symposium addressed future directions in international corporate governance.² A list of the speakers is included in Appendix 1. This paper aims to establish the 'cutting edge' in corporate governance. In other words, what are the 'cutting-edge' themes in corporate governance today? Specifically, the paper's objectives are to:

- summarise the main themes arising from the speakers' presentations and subsequent debate with delegates
- identify the cutting-edge issues in contemporary corporate governance
- locate these issues within the existing body of academic and practitioner corporate governance literature
- draw out future research agendas in corporate governance which need to be addressed by both the academic and practitioner communities.

The paper deals with the main issues in corporate governance arising from the two symposia as a series of themes. Section two introduces the background to the current agenda for corporate governance reform and harmonisation. Section three discusses the themes in turn, as they arose from the two symposia. The paper concludes, in section four, with a summary of the cutting-edge themes arising from the symposia, and draws out suggestions for future research in the area, making some policy recommendations.

1 A one-day symposium, organised by the BAASIGCG, was hosted by ACCA in London on 9 February 2006. The subject of the day was 'Shareholder and Stakeholder Relations'.

2 This was also a one-day symposium, organised by the BAASIGCG, hosted by ACCA in London on 30 May 2007. The subject of the day was 'Future Directions in International Corporate Governance'.

2. The background

Corporate governance is accelerating in its global importance and relevance. The current global financial crisis is identifying corporate governance weaknesses as the main causes of bank failures and the collapse of market confidence. There is no doubt that the agenda for UK corporate governance reform over the last 16 years, since the publication of the Cadbury Report (Cadbury 1992), has made significant progress in improving the way in which companies are controlled and directed. However, recent events in financial institutions demonstrate that far more work needs to be done. Within a broad, 'comply or explain' framework, a series of codes of practice, policy recommendations and policy documents have tackled corporate governance issues from every angle. The UK has been a net exporter of corporate governance initiatives, with the Cadbury Report inspiring a global proliferation of codes of practice and principles for good corporate governance. Since the Cadbury Report's publication, nearly every country around the world has developed a code of corporate governance best practice, with international-level codes of practice and principles being established by leading organisations such as the OECD and the International Corporate Governance Network (ICGN) (Solomon 2007). We will consider these international developments in more detail throughout the paper.

Board effectiveness has undergone intense scrutiny, with corporate governance focusing on executive remuneration, the independence and effectiveness of the non-executive director function, and reducing the top-heavy power in the boardroom by splitting the CEO and chairman roles. Boards have been made acutely aware of their accountability to shareholders and other stakeholders and of the importance of building and maintaining communication and trust with these essential groups.

Corporate governance reform in the UK and elsewhere has focused on improving the role played by institutional investors. Since Cadbury 'looked to institutional shareholders' to be more responsible in their shareholding, there has been an explosion of initiatives aimed at encouraging shareholder advocacy. Corporate governance initiatives have also focused on improving corporate transparency, by legislating better accounting structures and recommending improvements in the audit function and financial reporting. In the corporate governance rhetoric, reducing information asymmetries by providing better information to shareholders and stakeholders has been given primacy. The crucial role of public and private reporting of financial and non-financial information in forging links with shareholders and stakeholders, by creating a dialogic relationship and nurturing trust has been the focus of several policy initiatives (Tomorrow's Company 2004). The importance of dialogue and engagement in this regard has also been researched by the academic literature. This paper outlines the latest developments in the area of institutional investment and shareholder activism.

There has also been a paradigm shift in corporate governance, both theoretically and in practice. There is a

gradual move away from a solely shareholder-centric corporate governance framework to one which is more stakeholder inclusive. Companies are widely involved in stakeholder engagement programmes and are increasingly concerned with discharging their accountability to society. Social and environmental, sustainability, and corporate social responsibility reporting by the business community are continuing to rise (KPMG 2005; 2006). Increasingly, sustainability and corporate social responsibility reports are undergoing assurance, and this assurance process is starting to involve a broad range of stakeholders (O'Dwyer and Owen 2005; Edgley, Jones and Solomon 2007). Institutional investors concern themselves with corporate social responsibility by taking sustainability issues into consideration in their investment decisions and in their meetings with investee company management (Solomon and Solomon 2006). This change in attitude has arisen from changing perceptions about the influence of corporate social responsibility on value. There is growing evidence that corporate social responsibility does not reduce value and can in fact create value and lead to value maximisation in the long term (for example, Cobb et al. 2005). This move towards greater stakeholder inclusivity is discussed within the current paper.

Another dimension to the corporate governance debate addresses the interface between corporate governance and ethics. To what extent is the notion of ethics a central theme for 'good' corporate governance? Corporate collapses such as Enron, WorldCom and Parmalat have emphasised the contribution of unethical activity at the most senior level of companies to corporate governance failure (Solomon 2007). Codes of practice (in the UK and Europe, for example) and legal corporate governance prescriptions (in the US) have resulted in corporate governance reform, but to what extent have these changes been absorbed in spirit? In other words, have they had an impact on the corporate ethical environment? Weaknesses in ethics among directors and senior management represent significant weaknesses in corporate accountability to stakeholders. Boards of directors are starting to implement a stream of ethical initiatives, including the adoption of a code of ethics, whistle-blowing policies, fraud prevention, addressing bribery and corruption and ensuring objectivity in financial reporting.

A 2007 survey of CFOs across Europe found a consensus view that building a culture of ethics had a higher priority than it did five years previously. The report also presents evidence to suggest that there is a link between financial performance and ethical performance (CFO Europe Research Services 2007a). Nevertheless, only a quarter of those surveyed were personally responsible for ethical practice in their companies on a day-to-day basis. Another, similar, survey investigated CFOs' views towards ethics in US listed companies to discover whether they felt a sense of personal responsibility for ethics, and how they viewed their role in creating an ethical corporate culture (CFO Europe Research Services 2007b). The study found that more than 90% of US companies surveyed had ethics policies in place, but few had processes in place to ensure they were being adhered to. Comparing the two CFO

surveys, US companies have adopted ethical codes more extensively than their European and UK counterparts. This indicates that the regulatory approach promulgated by the Sarbanes–Oxley Act 2002 has resulted in a proliferation of ethical codes. However, whether this represents a genuine improvement in ethical behaviour and culture within US companies remains to be seen. The report raises concerns that CFOs consider that they have ‘done’ ethics and need not reassess their ethical policies. A similar study, surveying the views of CFOs across Asian countries³ found similar results in the sense that the majority of participants placed a strong emphasis on cultivating and maintaining an ethical business environment (CFO Asia Research Services 2006). In summary, ethics, and its relevance to corporate governance, is becoming an increasingly relevant issue not just for listed companies in the UK, Europe and the US, but also for developing economies, as we shall see from the discussion later in this paper.

³ Specifically, the study included CFOs and senior finance executives from mainland China, Hong Kong SAR, Malaysia and Singapore.

3. Cutting-edge themes in corporate governance

This section outlines the main ‘cutting edge’ themes arising from the discussions and presentations at the two symposia.

3.1 GLOBAL CONVERGENCE IN CORPORATE GOVERNANCE

As a result of heightened interest in, and awareness of, corporate governance issues at a global level, a series of international institutions have evolved to promote greater transparency, enhanced board effectiveness, greater protection of shareholder rights and improved stakeholder accountability. This general approach has been promoted by the OECD revised principles (OECD 2004) which espouse the following basic principles for ensuring the basis for an effective corporate governance framework:

- rights of shareholders and key ownership functions
- equitable treatment of shareholders
- role of stakeholders in corporate governance
- disclosure and transparency
- responsibilities of the board.

Mallin’s (2006) presentation ‘Shareholder and Stakeholder Relations’ outlined the development of these institutions and their role in improving international corporate governance standards. The International Corporate Governance Network (ICGN) was founded in 1995, as a result of institutional investors’ collaboration. The group includes investors, companies, financial intermediaries, academics and other interested parties. The ICGN established one of the first sets of principles for global corporate governance ‘best practice’. Among the group’s stated aims is to facilitate international dialogue on issues of concern to investors (ICGN 2005).

In her presentation, Mallin stated that the ICGN applauds the OECD principles as a declaration of minimum acceptable standards for companies and investors around the world. Further, she pointed out that although most countries have now developed codes of best corporate governance practice (or are in the process of developing them), one country stands out in its emphasis of an inclusive approach to stakeholder groups in corporate governance, namely South Africa. The two *King Reports* (IDSIS 1994; 2002) highlight seven primary characteristics of good corporate governance: discipline, transparency, independence, accountability, responsibility, fairness and social responsibility.

Mallin (2006) concluded that, globally, corporate governance is increasingly viewed as essential for protecting shareholder rights, safeguarding assets, realising value and creating competitive advantage. Companies are accountable to their shareholders principally but should also have regard for the interests of stakeholders. Institutional investors’ power and influence have grown in many markets and continue to do so. There

has also been a significant growth in socially responsible investment (SRI), as discussed later in this paper.

3.2 RISK, RANKING AND CREDIT RATING IN CORPORATE GOVERNANCE

In his presentation, Butler (2007) stated that the Holy Grail was to demonstrate that improvements in corporate governance add value to companies. The number of variables that constitute corporate governance are so vast that it would be impossible to determine the answer to his question. However, in presentations by both Dallas (2006) and Delsaux (2007), the strong negative impacts of weak corporate governance on financial performance were emphasised. It is now widely acknowledged that corporate scandals and corporate failures have been linked to corporate governance weaknesses. However, as Dallas (2006) stressed, the evidence of a positive link between ‘good’ corporate governance and corporate financial performance is less forthcoming. There is, however, an increasing emphasis on corporate governance for positive reasons, and a growing perception that companies which are run more efficiently and which demonstrate good corporate governance inspire confidence in investors and other stakeholders. The positive effects on trust, confidence, credibility and reputation lead to long-term value creation and shareholder wealth maximisation (Butler 2007; Dallas 2006; Delsaux 2007).

As the importance of corporate governance reform is becoming more widely recognised by companies, investors and other stakeholders, various organisations are beginning to provide detailed information for interested parties on corporate governance within individual companies. Some organisations have started to provide corporate governance ratings and to factor corporate governance into other forms of investment analysis, such as credit ratings. There is an increasing institutional investor demand for measurements of corporate governance, which are comparable across international boundaries and between companies. Most ratings incorporate international corporate governance guidelines such as those produced by the OECD (2004).

In his presentation, Dallas (2006) adopted a risk-based approach to corporate governance to demonstrate the way in which corporate governance issues were being incorporated into Standard & Poor’s credit rating processes. He emphasised that human nature is a perennial risk factor in business and is, from his perspective, a core corporate governance issue. In this risk-based corporate governance framework, Dallas stressed that there was mixed evidence as to whether ‘good’ corporate governance creates value and that it was actually impossible to pin down whether there was a significant relationship between effective corporate governance and corporate financial performance. However, if the issue was regarded from another angle, a significant negative correlation has been demonstrated by research and by case examples. As Dallas explained, it is indisputable that ‘bad’ corporate governance destroys value. There have been several exceptional cases where

severe corporate governance weaknesses have led to corporate collapse (Enron and Parmalat to name but two). This is why risk is a most important corporate governance issue for investors. This is the essence of a business case argument for corporate governance and accountability. Reputation risk is now a primary issue in corporate risk management and internal control.

Dallas (2006) discussed how credit ratings are adjusted to accommodate aspects of corporate governance. It is notoriously difficult to incorporate qualitative corporate governance factors into investment analysis. He likened the analysis and measurement of these 'soft' issues to the medical examination of soft tissues via x-rays and scans. Such examinations tend to reveal any deep-seated problems in the corporate, as in the human, body. The techniques applied by Standard & Poor's included a first level of analysis, which involved screening companies and using filtering mechanisms in order to find out which companies required closer investigation. Dallas presented an analytical approach to corporate governance which considered corporate governance according to four broad components which form the foundation of the assessment criteria. The components are: ownership structure and external influences; shareholder rights and stakeholder relations; transparency, disclosure and audit, and board structure and effectiveness.

In a global context the challenge is to assess individual governance practices in individual companies in the context of their business, legal and regulatory environment. There is no single structural approach that is appropriate for all firms in all jurisdictions. Companies need to be assessed on a case-by-case basis, and their governance structures and processes are best approached through broader norms and global principles on corporate governance, such as fairness, transparency, accountability and responsibility. This represents the lens through which Standard & Poor's analyses corporate governance. In conclusion, Dallas stressed that although there had been substantial worldwide improvements in corporate governance, companies should not be self-congratulatory.⁴

3.3 CORPORATE GOVERNANCE REFORM IN THE EUROPEAN UNION

In his presentation, Delsaux (2007) outlined the issues covered under the corporate governance remit of the Commission of the EU. One of the long-standing aims of the EU has been to achieve integrated financial markets. He highlighted the importance of raising market confidence to achieving financial market integration and suggested that corporate governance had a key role to play in nurturing confidence within financial markets. He outlined the action which the EU has taken with respect to corporate governance.

⁴ The ideas espoused by George Dallas are also portrayed in a book he has edited, *Governance and Risk: An Analytical Handbook for Investors, Managers, Directors and Stakeholders* (Dallas 2004).

3.3.1 'One size does not fit all'

First, the European Commission has adopted the overarching attitude towards corporate governance that, 'one size does not fit all', based on the belief that it is not possible to have one set of corporate governance principles for all EU members. The EU must leave flexibility for member states because, in Delsaux's view, corporate governance depends, *inter alia*, on corporate legal frameworks, and these vary tremendously across EU member states. It is, however, widely acknowledged that culture and traditions also have a significant impact on corporate governance developments and practice in countries around the world. As a result of the wide diversity of national legal frameworks, cultures, traditions, religious beliefs and patterns of corporate ownership structure, there are as many variations in corporate governance as there are countries in the world (Solomon 2007). In the EU, there are also many different internal corporate governance structures and mechanisms, such as board structure and composition. Delsaux (2007) emphasised that member states need to be allowed the flexibility to apply corporate governance in an individual manner, according to a principles-based, rather than a rules-based, approach. Therefore, the European Commission has decided that legislation should not be the driving force for corporate governance reform within the EU. Harmonising corporate governance across the EU through legislation, the forced adoption of a common code, is not considered a practicable possibility. As a consequence, the European Commission has decided to apply the 'comply or explain' approach to corporate governance (pioneered by the UK) as a key driving mechanism for improving corporate governance, across all EU member states.

3.3.2 The important role of shareholders

Secondly, the European Commission has established that the driving force for good corporate governance should be shareholders. Shareholders are an essential corporate governance mechanism for holding companies to account. They should be fully informed and should act responsibly by exercising their voting rights. However, as Delsaux (2007) explained, there are ongoing problems with corporate governance reform within the EU, the primary one involving shareholders. If shareholders are to drive corporate governance reform, they need to be able to exercise their rights. They should be able to vote and there are significant obstacles to cross-border voting at the moment. Therefore, a key issue for the European Commission is to facilitate cross-border voting.

3.3.3 Control-enhancing mechanisms and the 'one share: one vote' debate

Delsaux (2007) discussed one controversial and challenging issue for companies and their shareholders within the EU, namely the debate surrounding 'One share: One vote', which is based on a demand for every shareholder to own one voting right for every share he/she owns. This is a core corporate governance principle, deriving from the established need to treat all shareholders equally (OECD 2004). In many companies in member states the ratio can be 10, 20, or even 100 votes per share, for certain privileged shareholders. The privileged shareholders can be, for example, founding family members. This means that even where shares are sold to other shareholders, the rights on the new shares are often different (one share: one vote) such that the founding family members retain control. Delsaux (2007) commented on the serious and negative impact that this situation can have on corporate governance and accountability. The implication is that founding family members retain control of companies, through complicated ownership patterns, which can, potentially, lead to cronyism, abuse of power, obfuscation and corrupt behaviour. A drastic change to legislation would mean that if all shareholders were to possess one vote for every share they held, then the founding family could lose control over the company.

There has been substantial research into this area. The Association of British Insurers (ABI) commissioned a study into the application of the 'one share : one vote' principle in Europe (ABI 2005). This study, conducted by the Deminor Rating Agency, examined the capital structure of companies within the EU in order to establish what proportion applied the 'one share: one vote' principle. The findings indicate that 65% of the companies analysed applied 'one share : one vote', but identify some 'striking' exceptions to the principle. Multiple voting rights were found for companies across member states, but especially in France, Sweden and the Netherlands.⁵

The EU produced an in-depth report on the proportionality principle in the EU in May 2007 (European Commission 2007).⁶ This study identifies a far wider range of control-enhancing mechanisms which do not follow the proportionality principle, but which are used widely throughout member states. The findings of the study suggest that a 'one share : one vote' policy would not per se alleviate the difficulties of excessive control by concentrations of shareholders. Other control-enhancing mechanisms include: pyramidal

structures, available in all the member states surveyed and used in three-quarters of them; shareholder agreements available in all the countries surveyed and used in 69% of them; and cross-shareholdings used in 31% of the countries surveyed (European Policy Forum 2007). These are in addition to the issue of dual-share systems, which were found to be less frequently employed than the other mechanisms. Although 'one share: one vote' has been advocated by institutional investor representative organisations, there has been resistance from the European corporate community, who favour investor choice, with transparency, rather than regulation of dual-share classes, being the essential mechanism of accountability (European Policy Forum 2007).

3.3.4 Board structure and performance

In relation to board structure and performance, Delsaux explained that there had been EU-wide adoption of good corporate governance practice with respect to the appointment of non-executive directors on corporate boards. However, he admitted one qualification, that the definition of independence has been applied in a 'flexible' manner. He also asserted that the disclosure of remuneration is more positive and is now a reality for most member states. In terms of accounting at EU level, Delsaux (2007) considered that member states were performing well and that the EU accounting directive has applied since 2005. It has, in his view, been a success. However, Delsaux (2007) highlighted the difficulties related to International Financial Reporting Standard (IFRS) 8, especially for small and medium-sized enterprises (SMEs), and he emphasised the need for consultation in this area. Consequently, the EU is launching a committee to consider a simplification exercise which will provide a way forward for simplifying accounting rules for SMEs.

3.3.5 Choice of language for corporate communications

Another area highlighted by Delsaux was that of language used in corporate communications with shareholders (and other stakeholders). For example, which language should be used for the annual general meeting? Which language should corporate disclosures and documents be presented in? How can shareholders exercise informed votes if they cannot understand the language in which voting forms are presented? There is a need for extensive research into these issues.

5 The 'deviations' from the 'one share: one vote' principle found by the study were: multiple classes of share; shares with multiple voting rights; non-voting shares without preference; voting-right ceilings; ownership ceilings; priority shares; golden shares, and depositary receipts.

6 The proportionality principle is explained as follows, 'proportionality between ultimate economic risk and control means that share capital which has an unlimited right to participate in the profits of the company or in the residue on liquidation, and only such share capital, should normally carry control rights, in proportion to the risk carried. The holders of these rights to the residual profits and assets of the company are best equipped to decide on the affairs of the company as the ultimate effects of their decisions will be borne by them' (European Commission 2007: 7).

One of the evident problems for the European Commission is enforcement and sanction. If EU members are not implementing corporate governance recommendations and directives properly, what role does the European Commission have in enforcing/policing after providing the recommendations? Delsaux (2007) explained that the European Commission's approach to dealing with such problems in corporate governance is as follows:

1. Consultation.
2. Recommendation or directive.
3. Ex post-evaluation.
4. If recommendations or directives do not deliver then their usefulness is questionable.
5. If objectives not achieved, ex post, what can be done next?

An evaluation is necessary after regulation. Evidently, encouraging diverse member states to comply with corporate governance directives in a 'comply or explain' environment is a difficult task.

We now turn to the ways in which similar problems arise in developing economies around the world.

3.4 CORPORATE GOVERNANCE IN DEVELOPING ECONOMIES: THE CASE OF UGANDA

The 'one size does not fit all' problem is not restricted to the EU, but is relevant to countries across the globe. There are particular difficulties in establishing codes of practice for corporate governance in developing economies, where corporate governance combines with political, economic, cultural and other factors. However, as stressed by the OECD (2004), good standards of corporate governance are essential if countries are to attract international investment. Wanyama (2007) provides a fascinating insight into emerging issues in corporate governance in one African economy (see also, Wanyama, Helliard and Burton 2007). Research into corporate governance in Africa is in its infancy and Wanyama's study represents the first attempt to reflect on corporate governance issues in Uganda. The aim of the research was to examine whether the publication of principles of corporate governance led to significant improvements in corporate governance in Ugandan companies. The primary issue is whether guidelines are enough to develop good corporate governance, or whether more is needed.

The corporate governance codes in Uganda were established in reaction to corporate failures, with the first principles for good corporate governance published in 2003 by the Uganda Capital Markets Authority (UCMA 2003). Although the guidelines themselves are excellent, there are many persistent problems which hinder the establishment of good corporate governance in practice.

The research consisted of interviews and questionnaire surveys, which targeted a wide range of groups involved in corporate governance developments, including regulators, legislators, employees, directors and non-executive directors, investors, owner-managers, lawyers, accountants, academics and civil servants. The general consensus was that:

'...the level of implementation of corporate governance guidelines in Uganda is poor...[and is] attributed...to the lack of an appropriate framework to support implementation and enforce compliance with the guidelines' (Wanyama et al. 2007: 16).

This appears to be due partly to the scarce knowledge that essential groups, such as boards of directors and employees, had about corporate governance concepts. The research participants also considered that the legal framework promoting corporate governance reform in Uganda was inadequate and ineffective. However, the participants also identified cultural and social factors which impede corporate governance improvements in Uganda. These include: pressure from extended families for financial support, leading to bribery and corrupt practices; hierarchical structures, relating to heads of families and age; sexism and tribalism. There were also economic factors which were thought to hinder corporate governance reform, including tax levels, remuneration, inflation and poverty.

Shareholder advocacy, and the means by which shareholders can hold boards to account, was also identified as a serious weakness in Ugandan corporate governance. Owing to private/family ownership structures, it is difficult for shareholders to exercise their rights and extremely difficult to encourage shareholders to act in Uganda.

Another salient issue for Ugandan corporate governance is the need for ethical business practices. Unethical conduct within the corporate sector was considered to be a significant obstacle to good corporate governance, including: sexual harassment of employees; fear of whistle blowing (as employees would lose their jobs); political and other corporate appointments not based on merit; bribery and corruption; poor accounting disclosures; lack of ethical characteristics among senior corporate employees, such as integrity, punctuality, honesty and accountability. There is inadequate protection of employees' rights, which therefore leads to exploitation and harassment of employees.

Overall, Wanyama (2007) concludes that although formal structures are in place, existing frameworks are inadequate for supporting and ensuring good corporate governance. In terms of recommendations, Wanyama (2007) comments that company law in Uganda has not been revised since 1964 and that change is well overdue. He suggests that:

'... extra resources need to be provided to enable the legal, regulatory and enforcement agencies to perform their

work adequately, while the governance framework also needs to take into account the specific cultural context of Uganda, where respect for elders and the protection of the family is a major concern. In addition, the economic policies of the country need to be scrutinised to ensure that they foster and nurture good corporate governance practices in Uganda, most fundamentally by ensuring that the population...receives a fair wage or living allowance so that the motivation to cheat or take bribes is reduced' (Wanyama et al. 2007: 31–2).

Wanyama (2007) also emphasises the need to improve education, in order to raise awareness and understanding of ethics, and highlighted the urgent need for improvements in the accounting framework. This insight into corporate governance in Uganda highlights the gap between the establishment of guidelines and their implementation. Although little work exists at present, it is likely that other African economies, and indeed other developing economies elsewhere, are experiencing similar obstacles to corporate governance reform. Far more needs to be done to identify these obstacles and to find ways of reducing or removing them. Further, there is a need to investigate the interface between ethics and corporate governance in emerging economies, in the same way as ethics is being researched in developing economies at present (CFO Asia Research Services 2006; CFO Europe Research Services 2007a; CFO Europe Research Services 2007b). The relevance of ethical behaviour to improving corporate governance is being recognised increasingly on the international stage.

3.5 THE ROLE OF INSTITUTIONAL INVESTORS IN IMPROVING CORPORATE GOVERNANCE

Since the publication of the Cadbury Report in 1992, the role of institutional investors in promoting 'good' corporate governance has become the focus of numerous policy recommendations and guidelines in the UK. At a global level, as we commented earlier, one of the main issues in the OECD Principles is the equitable treatment of shareholders and the rights of shareholders (OECD 2004). As a result of these initiatives, a closer, more intimate, and critical relationship is purported to have developed between companies and their core institutional shareholders.

It is indisputable that institutional investment now dominates UK ownership structure. As Mallin (2006) noted, based on Office for National Statistics (UK) (ONS) data at the end of 2004, the largest owners of UK shares were the insurance companies, with 17.2% (£254.2 billion), the pension funds with 15.7% (£232.6 billion) and overseas investors with 32.6% (£483.2 billion). This pattern shows a complete reversal over the last 50 years, as at that time institutional investors were minority shareholders, with most company shares owned by individual shareholders (Briston and Dobbins 1978; Mallin 2006).

Although extensive efforts have been made worldwide to improve the situation for shareholders' awareness of their

rights and ability to exercise those rights, it is increasingly evident that there is a need for continued efforts in this area. As corporate governance becomes progressively standardised at a global level, international investment by financial institutions in stock markets around the world continues to rise. One substantial means of furthering the rights of shareholders internationally is the effort by the institutional investment community to raise the thresholds of shareholder activism. At both symposia there was significant discussion and debate on the areas where work was ongoing and where greater attention was required. We consider below the outcome of these discussions in terms of (i) issues of conflict and trust in institutional investment, (ii) shareholder activism: engagement and dialogue, and (iii) shareholder activism: voting.

3.5.1 Issues of conflict and trust in institutional investment

In his presentation, Melvin (2006) highlighted the notoriously complex structure of UK institutional investor ownership (see also Solomon and Solomon 2004). Melvin is involved at the forefront of developments in institutional investment, as Hermes, a leading UK-based fund manager, has always been a leader in investor advocacy. This complicated ownership structure exacerbates conflict, as there are many intermediaries involved in the chain of ownership and accountability in pension fund investment. The involvement of trustees, brokers, investment consultants, fund managers, and analysts muddies the waters of accountability between the ultimate 'shareholder' (the pension fund member/beneficiary) and the investee companies. Therefore, not only is there the classic agency problem between the principal (shareholder) and the agent (director), but this is exacerbated by the presence of these intermediaries. Their involvement creates frictional transaction costs (as outlined in Myners 2001) and result in the practical severance of any genuine chain of accountability. Melvin concluded that it is damaging to have the interests of the owner diluted by those intermediaries who profit from their involvement but who are not involved in the investee company. The genuine shareholder perspective is not being heard by companies because of these ownership conflicts and therefore value is being lost due to the lack of a working relationship.

According to Melvin (2006), it is this complicated ownership structure which has contributed to a breakdown in trust between companies and their shareholders. Indeed, such a breakdown in trust among members of society regarding institutions and organisations has been the focus of investigation (Myners 2003) and has stimulated the production of a report examining ways of rebuilding trust (Tomorrow's Company 2004). As Melvin states, institutional investors now need to examine their own governance structures in order actively to rebuild trust among their beneficiaries. Notably, a discussion paper issued by the National Association of Pension Funds (NAPF) (NAPF 2005) examines pension scheme governance. The report concluded that there was no effective mechanism in place to represent the collective interests of the millions of pension scheme members after they enter their schemes. In other words, the report shows there to be a 'governance vacuum' in pensions

governance. Consequently, the paper recommends the formation of three potential governance structures to fill this gap: a trust board, a pensions management committee, or a pensions committee within pension funds.

The decline in trust in the UK institutional investment industry has raised a need for institutional investors to pioneer shareholder activism. We now consider the two main areas where the institutional investment community has focused on becoming more active: engagement and dialogue ('relationship investing'), and voting.

3.5.2 Shareholder activism: engagement and dialogue

The Cadbury Report (Cadbury 1992) represents the first attempt to encourage institutional investors to act as responsible owners and to engage with their investee companies. Following Cadbury, the Myners Report (Myners 2001) emphasises the importance of developing a 'winning partnership' between institutional investors and their investee companies. Further, Monks and Minow (1994) emphasises the need for institutional investors to practise what he terms 'relationship' investing' with their investee companies.

Another important initiative in the area of shareholder activism has been the publication, in October 2002, of *The Responsibilities of Institutional Shareholders and Agents: Statement of Principles* for institutional investors by the Institutional Shareholders' Committee (ISC) (2002).⁷ The Higgs Report (DTI 2003) expresses support for this 'Code of Activism', requesting that it should be endorsed by the revised *Combined Code on Corporate Governance* (FRC 2003). The ISC Code establishes a benchmark for institutional investor practice in the areas of engagement and voting.

The ISC has produced guidelines which commit institutional investors to understanding company objectives and intervening appropriately, engaging with companies where necessary. To this end, it is essential that institutional investors hold meetings with their investee company directors if they are to stand any chance of gaining a genuine understanding of those companies from the inside.

3.5.3 Engagement strategies

In his presentation, Butler (2007) describes the activities of the activist independent fund that he manages and which he considers provides a catalyst for change that can unlock value and motivate underperforming companies to improve their performance. The approach of the 'governance for owners' fund is derived from Robert Monks' framework for 'relationship investing' (see Monks 2001, for example). Indeed, Monks assisted Butler and his colleagues in adapting his relationship investing model to the UK market. According to Butler (2007), 'relational' investing incorporates:

- investing in underperforming public companies where value can be added through exercising share owners' rights
- engaging with the executive and non-executive teams of investee companies on strategic and structural governance issues (see below)
- consulting with other investors and share owners on ownership issues.

Butler (2007) discusses the difficulties of establishing a programme of engagement and dialogue with investee companies. He states that it takes on average between six and nine months to establish a relationship with the CEO and directors of a company.

Butler suggests that institutional investors should engage on two levels: strategic and structural. He considered that strategic issues are of critical importance to adding or destroying value. For example, strategic issues include making recommendations on dividend policy. Strategic governance includes engagement on board composition, corporate strategy and capital structure. Structural issues involve 'good housekeeping'. Structural governance issues include engaging on internal controls, executive remuneration and corporate responsibility. Butler suggests that corporate governance devotes 95% of the time to box-ticking, 'housekeeping' issues, which are essentially structural rather than strategic. He states that although this is important it demonstrates a misguided emphasis. In summary, one of the themes of Butler's presentation is his recommendation that corporate governance needs to be far more focused on strategic issues.

3.5.4 Advice to institutional investors: what to avoid

There are a number of approaches that institutional investors should avoid at all costs in their programmes of engagement and dialogue. Butler (2007) emphasises that institutional investor engagement should never aim to 'micromanage' investee companies. This is emphasised in the Hampel Report (Hampel 1998), which states that: 'Institutions are not normally experienced business managers and cannot substitute for them. But we believe that they can take a constructive interest in, and test, strategy and performance over time'.

Butler emphasises that institutional investors should be involved in strategic and structural issues, rather than in attempts to micromanage companies. Another approach which should be avoided, according to Butler, is 'naming and shaming' of companies. Involving junior staff in relationship investing is also to be avoided, as a broad and sophisticated skills set is required. It is essential for institutional investors to earn credibility and they cannot do this if they involve junior staff in relationship investing.

⁷ The members of this Committee are: the Association of British Insurers; the Association of Investment Trust Companies; the British Merchant Banking and Securities Houses Association; the National Association of Pension Funds and the Investment Management Association.

3.5.5 A gap between institutional investor rhetoric and practice?

Although investment institutions state openly that they are engaging with their investee companies, Melvin (2006) questioned their genuine commitment to the level of engagement and dialogue they actually practise. He stressed that the resources that are being dedicated to active engagement policies are inadequate and belie any genuine commitment to this essential activity. If institutional investor engagement programmes are to be run and managed effectively, it is essential that they be supported both by the owners and their clients. Substantial resources need to be channelled into these programmes. At Hermes, Melvin (2006) states that there were 50 people dedicated to corporate governance, approximately four to five times more than in any other investment institution.

3.5.6 Does responsible investing add value?

Although responsible shareholding in the form of engagement and dialogue has been a primary ingredient in corporate governance recommendations over the last 15 years, little evidence has been provided to show that it results in higher investment returns. There has been a general inability by researchers to demonstrate a significant (or even existent) positive relationship between shareholder activism and financial performance (see, for example, Karpoff 2001; Nesbitt 1994; Smith 1996; Gillan and Starks 1998; Black 1998; Del Guercio and Hawkins 1999, and Anson, White and Ho 2004). Clearly, there needs to be a business case for shareholder activism or institutional investors will not be incentivised to pursue it. However, Butler (2007) provides contradictory findings of an academic study, commissioned by his own fund, into shareholder engagement.

The study (Becht, Franks, Mayer and Rossi 2006) provides definitive evidence that engagement by active shareholders adds value. The fund provided academics at the European Corporate Governance Institute (EU) (ECGI) full access to all the documentation relating to the Hermes UK Focus Fund. This represents the first academic study of its kind. Butler emphasises the riskiness of conducting the survey, as it was possible that the results might not support the Fund's strategy for relationship investing. Fortunately, this did not turn out to be the case. The study provides the first robust evidence that engagement can be effective: 'In contrast with most previous studies of activism, we report that the Fund substantially outperforms benchmarks and estimate that the abnormal returns are largely associated with engagements rather than stockpicking' (Becht et al. 2006: 2).

The Fund adopts an active approach if it believes that it (i) considers the company is underperforming, (ii) can engage the company successfully, (iii) expects to obtain at least 20% more value than the current share price (a triple investment criterion). The analysis involved examining 41 investments made by the fund between October 1998 and December 2004.

The study examines cases where companies had

outperformed as a result of intervention by the Fund. The researchers report how 90% of the outperformance of the shares under study was attributable to engagement rather than to stockpicking, emphasising the positive impact of active engagement. They conclude that: 'A high proportion of the intervention is successful and results in substantial shareholder gains, particularly in response to restructurings and board changes. These successful outcomes account for a large proportion of the significant out-performance of the Focus Fund relative to a variety of benchmarks over the sample period' (Becht et al. 2006: 25).

Butler comments that in his view this proportion of outperformance is too high but suggests that common sense implies that most outperformance arises from engagement rather than stockpicking. Again, for him, these findings highlight the fact that strategic governance should be the most important issue for investment institutions. Although the study used only UK evidence, Butler (2007) considers that the findings would be mirrored in European data.

In the study, the academic researchers categorise the style of engagement as either collaborative or confrontational. Becht et al. (2006) define collaborative engagements as those where the target agreed with changes sought by the Fund, implementing them in collaboration with Hermes. In contrast, confrontational engagements involve disagreement about the Fund's objective from the outset and usually resulted in the removal of the CEO and/or chairman. In a few specific cases, the academics interpret some of the issues as confrontational, whereas Butler himself has interpreted them as collaborative, such as in the case of changing the CEO, but working with the chairman to remove him. This illuminated differences in attitude between the academic and practitioner communities. It is noted that confrontational engagements took nearly three times as long to complete as collaborative engagements. The most extreme case involved 48 meetings with the companies involved.

As part of the research, the academics carried out an event study to discover whether engagement objectives were value enhancing. The analysis involves 98 events across 30 engagements. In a separate Singaporean case study, which Butler refers to in his presentation, minority shareholders were represented and won their case. This has opened the doors to relationship investing with companies in Singapore for the activist fund. In a similar German case study, the independent partnership Governance for Owners carried out 41 meetings over 15 months. This is a phenomenal level of engagement and dialogue.

Clearly, in cases where there was significant confrontation, costs were likely to rise. Although Butler acknowledged that there was a temptation to walk away in such cases, this was usually resisted. If the shareholder gives in too easily, then boards would use this as an excuse to say no to them as they would know that the shareholder would eventually give up and go away. Therefore, as active shareholders, the fund managers have to commit

themselves to persevering with an issue when they have started the engagement. The only cases where the Fund has admitted defeat are those where they can not rally support from any other institutional investors. There was another case when the CEO/chairman would not engage and they realised quite quickly that they were wasting their time as it was not possible to create any sort of dialogue at all.

3.5.7 Recommendations for improving engagement by institutional investors

Collaboration between institutional shareholders in terms of engagement and dialogue is an important factor. Unless institutional investors can rally the support of others, it is difficult for them to have a significant impact on investee companies. Melvin (2006) offered practical solutions to enhancing trust and improving institutional investor activism, which are currently being explored by his own organisation and other global investment institutions. The primary suggested solution was to create a group of institutional investors at an international level who will collaborate in order to improve accountability in institutional investment and restore trust. This would help to remove what may currently be termed ‘irresponsible activism’ (Melvin 2006). In order to collaborate, this group of investment institutions should share resources, so as to take advantage of economies of scale.

Another means of improving corporate governance through shareholder activism is the increased and enhanced use of voting rights, especially cross-border voting rights. This is the subject of the following section.

3.5.8 Shareholder activism: the use of voting rights

The use of voting rights by institutional investors has increased significantly in recent years (Mallin 1999). Patterns of institutional investor voting have been analysed in detail (Mallin 1996; 2001). However, despite encouragement to vote from the NAPF (NAPF 1995), for example, overall voting by institutional investors remains below 40% (Hampel 1998). *The Combined Code on Corporate Governance* (FRC 2003) specifies that institutional investors have a responsibility to make considered use of their voting rights (FRC 1998, para. E1). There has been ongoing debate on whether institutional voting should be mandatory. The Hampel Report emphasised the importance of keeping the use of voting rights voluntary and not moving toward regulation.

The Shareholder Voting Working Group, chaired by Paul Myners, has issued two reports (Myners 2004; Myners 2005). These reports detail the various impediments to voting, highlighting the complexity of the voting system, and making recommendations in a number of areas to help improve the situation and remedy the problem of ‘lost’ votes. These recommendations relate to:

- the importance of beneficial owners in the process
- improving operational efficiency
- clarifying voting entitlements.

The Shareholder Voting Working Group investigated:

- systems and controls at custodians and investment managers
- enhancing institutional investors’ procedures
- enhancing procedures at company meetings
- the importance of issuers
- the widespread adoption of electronic voting, which should improve the overall situation.

One of the cutting-edge issues for corporate governance globally is the need to facilitate the exercise of voting rights not just at a national level but also across national boundaries.

3.5.9 Cross-border voting

In her presentation, Mallin (2006) discusses the possibility of promoting cross-border voting by institutional investors and electronic voting. Further, Wilson (2007) presents the findings of a survey conducted by the Manifest Voting Agency (Manifest Information Services 2007), which explored the obstacles to cross-border voting and makes recommendations for improvements. Wilson (2007) discusses how the British Commonwealth shares the UK approach to shareholder rights, and powers to exercise those rights, such that perhaps the UK and the British Commonwealth countries are ahead of the US and other countries in terms of shareholder rights and equitable treatment of shareholders. Wilson states that the US are now ‘looking across the pond’ to the UK to see what it has to offer the US for improving shareholders’ rights. In the US, voting does not hold significant value, and often, US shareholders have more rights abroad than they do in their domestic market. In her view, the UK has become a ‘beacon’ for good corporate governance in terms of shareholder rights, especially in the area of voting on directors’ remuneration, which is very important.

In terms of shareholder activism, Wilson (2007) stressed that dissent is an extremely important mechanism for shareholders in corporate governance, in terms of adding abstention votes as well as votes against the board. As emphasised by the Hampel Report (Hampel 1998) voting must not become a ‘box-ticking’ exercise. One of the most important issues in achieving meaningful voting is that directors need time and information to make informed choices. However, Wilson (2007) commented that although shareholders are being asked to be more diligent owners, the mechanisms are not in place to allow this to happen in practice.

The extensive study by the Manifest Voting Agency, referred to above, examines the major impediments to the voting process in Europe across 18 countries. The report identifies a broad array of reasons/issues which are impeding voting of shares internationally. However, as Wilson (2007) comments, in the EU, losing votes is a continuing problem and there is a lack of audit trails in

relation to voting. The Manifest study finds that informed voting levels have clearly risen and that there are different patterns of dissent coming through. There are serious obstacles to voting, identified by Wilson (2007), which need to be addressed urgently. One obstacle involves the existence and role of intermediaries. For example, she explained that the tabulators, who are responsible for counting shareholders' votes, display a lack of consistency in the way they operate. The implication is that inconsistencies in voting processes could result in inconsistent outcomes. A substantial obstacle to cross-border voting (and shareholder voting in general) is the timing of meetings across EU countries. As Wilson commented (2007), the situation is reminiscent of 'trying to get all the presents ready for Christmas', because there is a rapid convergence on April for companies' AGMs across Europe. This convergence makes it difficult for shareholders to make informed decisions, as they do not have adequate time to assess and respond to the relevant issues. The concentration of AGMs around April renders 'considered' voting extremely difficult for every company.

Another obstacle is the persistence in some parts of Europe of compulsory 'wet signatures'. As Wilson explained, handwritten signatures should no longer be necessary, given advances in electronic communications and technology, but some companies continue to insist on wet signatures on their voting cards. Physical attendance at AGMs is also a persistent problem. Sweden has only recently decided that shareholders should not be forced to attend meetings in person to cast their votes. Language problems represent another significant obstacle, as there is frequently little or no similarity between the original wording and translations. This is reflected strongly in Delsaux's (2007) discussion of problems in corporate governance across EU member states.

Overall, Wilson (2007) concludes that Manifest are recommending the implementation of the following improvements which will reduce the impediments to cross-border voting:

- provide sufficient and meaningful information further in advance of meetings on a consistent basis across Europe
- separate AGM and dividend dates to reduce stock lending activities around the AGM
- eliminate bearer shares in favour of electronic register
- possess a legal framework that allows delegation of voting authority to third parties under a power of attorney
- adoption of open standards and framework for voting messages
- use of segregated, rather than pooled, accounts
- enforcement of EU competition law with respect to bundling of services by banks and other securities intermediaries.

She emphasises that shareholders need to be given more time to make informed decisions on voting and that therefore European companies should avoid a convergence of their AGMs around one season.

3.6 THE IMPORTANCE OF AUDIT IN CORPORATE GOVERNANCE

As established in the Cadbury report (1992), audit is the 'cornerstone' of good corporate governance. Since the collapse of Enron, which was linked closely to audit failure, inter alia, significant steps have been taken worldwide to improve the independence and effectiveness of the audit function. The Sarbanes–Oxley Act (2002) in the US has forced the audit to expand in scope, taking risk management and internal control disclosures into its remit. The UK response to Enron included the publication of the Smith Report (FRC 2003), which focuses on the role of the audit committee but also highlights the importance of independence in audit. One direct result of Sarbanes–Oxley has been an increase in audit fees, resulting from the extended audit remit.

A striking outcome of the discussions at both symposia is the general concern about the audit function. A number of the speakers highlighted the need for more attention to be paid to audit. Indeed, audit was identified as one of the weakest areas in corporate governance. Certainly, in terms of cutting-edge themes in corporate governance, both symposia raised audit as an area where urgent attention is required. From the views expressed by several of the symposium presenters, the audit seems to be an area which is taken for granted, and which could represent a 'time bomb' in corporate governance (arguably since the presentation, this time bomb has detonated, in the form of the default in sub-prime related loans, and the ensuing liquidity crisis).

In the European context, the Committee of European Securities Regulators (CESR) has conducted a recent survey to assess the nature and amount of communication from the auditor to the company's shareholders and other stakeholders relating to the fairness of the accounts and on matters receiving specific attention in the audit process (CESR 2007: 9). The report concludes that:

'A majority of respondents agree that extra information... from the auditor to the public on the statutory audit could contribute to the decision-making ability of the public... auditor communication is a subject of public interest. In order to make recommendations the subject should be explored further'.

In the area of audit communication, there is urgent need for research into users' perceptions and needs. Indeed, the study called for more research in this area.

In his presentation, Delsaux (2007) considered that the EU was less advanced in audit than in the accounting area. Wilson (2007) commented that audits were being rushed. She noted that one of the large audit firms has expressed concern that the audit is not considered to be important

by users. There is pressure from companies to conduct more complex audits more quickly, given the increased focus on audit post-Enron. Wilson suggested that the 'heat and light of corporate governance' are being focused on the 'wrong' issues, with audit being one of the 'right' issues requiring urgent attention.

Simpson (2007) presented the findings of a survey of views on financial reporting and audit conducted by the ICGN (ICGN 2007). The survey approached shareholders to discover their views concerning audit, financial reporting and liability. However, because investors who join ICGN are generally interested in corporate governance and are leading-edge activists, Simpson (2007) admitted that the results were likely to be biased. There were 76 responses to the survey. The respondents comprised:

- 34% investors
- 32% consultants (eg proxy service providers).

Other respondent groups included fund management trade bodies, audit/accounting firms, companies and one law firm. These respondents were geographically distributed as follows:

- 33% from the US
- 28% from the UK
- 12% from Europe (excluding the UK)
- 13% from the Asia-Pacific region
- 11% from the rest of the world.

The respondents were asked for their assessment of the quality of financial reporting following the financial scandals of recent years. Of the respondents, 60% considered financial reporting had improved in quality, whereas 35% considered it was the same, and 3% suggested it had deteriorated. Sixty per cent of the respondents also considered that convergence between Financial Reporting Standards in the US and IFRS should be a high priority. Respondents were asked for their assessment of the role investors play in standard setting, with 80% stating that they were not involved enough.

In relation to auditing, the survey asked if there was a consensus as to the scope and purpose of the audit and the expected quality of the audit, and 55% of the respondents stated that there was not. Further, 45% considered that they were only 'somewhat satisfied' with the benefit they were receiving from the independent audit, although 30% did state that they were satisfied.

The respondents were asked to what degree they felt auditors focused on delivering a high-quality audit. In response, 50% considered they were mostly, and 40% that they were somewhat, focused. One reason offered for a lack of focus on high-quality audit was conflict of interest, with distractions being another reason. Further, 84% of the

respondents were concerned about audit quality in emerging markets and 85% felt that there were significant structural barriers to smaller audit firms in shaping the regulation of audit.

Corporate governance within audit firms was also raised as a serious issue, with respondents calling for audit firm disclosures in a number of areas: 85% of respondents wanted disclosures on quality control; 80% of respondents called for governance disclosures; 55% required disclosures on finances and 20–25% wanted corporate social responsibility disclosures.

Auditors' liability has been an important concern raised in recent academic research (see, for example Sikka 2007). Of the respondents, 65% thought liability should be proportionate, 10% unlimited (joint and several) and 10% thought it should be subject to alternative dispute resolution.⁸ Clearly, respondents were calling for alterations to the current state of auditors' liability. Concerns were raised that auditors do not communicate adequately due to unlimited liability, as they are risk averse. They were therefore tempted to say very little and hedge around issues. However, only 10% respondents called for capped liability, which is not enough to merit this happening.

On reflection, these results provide an interesting insight into the views of the financial investment industry towards the audit function. Although there is clearly concern that unlimited liability can have a negative impact on audit quality, because auditors are inclined to be excessively cautious, limited liability could have the reverse effect, by making them careless in the audit, again reducing audit quality. However, the market mechanism would be likely to correct this secondary negative impact, by forcing auditors to focus on quality, despite reduction in liability, as otherwise their insurance premiums would increase.⁹ Indeed, an interesting issue, not mentioned during the symposia, is the attitudes of the underwriters towards auditors' liability. To what extent do they consider that changes in auditors' liability may increase or decrease their risk? How do they adjust risk premiums in response to such changes? What impact would higher/lower risk premiums have on smaller audit firms? Limited liability may be beneficial to big audit firms, but may cripple smaller firms, owing to the impact of insurance cost.

3.7 PRIVATE EQUITY

In his presentation, Cheffins (2007) discussed the potential for an 'eclipse' to occur in private equity. Private equity aims to achieve superior risk-adjusted returns through the acquisition and privatising of publicly traded companies. A private equity firm does not buy the companies outright on its own behalf, but instead sets up buy-out funds financed by institutional investors that carry out the transactions. Cheffins explained how history could be used

⁸ This would cut costs significantly by going to binding arbitration.

⁹ This view arose from a comment by Dr. Simon Norton, Cardiff University.

to estimate the future trajectory of private buy-outs, and provided the findings of an academic paper he has written with Armour (Cheffins and Armour 2007). They consider regulatory and market pressures with the potential to slow down the recent rise of private equity and also consider the possibility that private equity firms, which are typically organised as partnerships, could themselves soon become publicly traded companies.

Cheffins explained that previous US merger waves offer lessons for the future concerning the market and regulatory pressures that could confront private equity. He noted that there are substantial similarities between issues relating to the conglomerates of the 1960s, the leveraged buy-out (LBO) wave of the 1980s and private equity today. In so doing, he identified antitrust law and tax regulation as regulatory schemes that could affect private equity. He also indicated that stock market and credit market trends could serve to influence private buy-outs, with debt being of particular importance.

Cheffins' predictions concerning private equity proved to be right on the mark, especially with respect to credit markets. In the summer of 2007, benign credit conditions that had fuelled the private equity boom went into reverse as a result of a 'credit crunch' spawned by a crisis concerning sub-prime mortgages. Public-to-private buy-outs have all but disappeared as a result, and private equity firms are even trying to reverse some of the deals they struck when market conditions were better.

Cheffins and Armour (2007) acknowledge in their paper that a market-driven reversal in public-to-private buy-outs might merely be temporary, citing the fact that such transactions were sidelined only temporarily after the leveraged buy-out boom of the 1980s collapsed. They argue that nevertheless an eclipse of the current version of private equity is likely. Until recently, the firms orchestrating the buy-outs have typically been secretive partnerships dismissive of public securities markets. This business model, Cheffins and Armour (2007) argue, could be turned on its head before long.

Noting that the private equity giant Blackstone carried out a public offering in the spring of 2007 and its leading rival KKR has plans to do likewise, Cheffins and Armour (2007) consider that publicly traded companies will soon orchestrate most major public-to-private buy-outs. This would be an ironic twist, given that Jensen, in a much cited paper, argues that LBO firms, 1980s predecessors to private equity firms, are paving the way for the eclipse of the publicly traded company (Jensen 1989). Cheffins and Armour's (2007) analysis indicates that the public company will, in fact, remain alive and well, since most future public-to-private buy-outs will likely be orchestrated primarily by publicly quoted companies.

3.8 CORPORATE GOVERNANCE AND STAKEHOLDER ACCOUNTABILITY

Corporate governance has broadened its remit in recent years. There has been an evolution in corporate governance from reference to a narrow agency theory, shareholder-dominated, approach attributable to Berle and Means (1991), Jensen and Meckling (1976) and their followers, to a broader and more inclusive corporate governance, which incorporates the needs and interests of stakeholders (Solomon 2007). Companies are now considering a stakeholder approach to corporate governance, which has in many cases evolved into an enlightened shareholder approach, with a business case motivation for stakeholder inclusivity. The OECD Principles have emphasised the need for stakeholder accountability, with the role of stakeholders in corporate governance being among their Principles (OECD 2004).

As Mallin (2006) discusses, international investment institutions have also started to advocate a more stakeholder-inclusive approach to corporate governance. The revised ICGN Principles have placed more emphasis on 'Corporate Citizenship, Stakeholder Relations and the Ethical Conduct of Business', stating that: 'the board is accountable to shareholders and responsible for managing successful and productive relationships with the corporation's stakeholders. The ICGN concurs in the view that active cooperation between corporations and stakeholders is essential in creating wealth, employment and financially-sound enterprises over time' (ICGN 2005: 9).

This is a particularly bold and far-reaching statement as it stresses a definite, acknowledged link between stakeholder accountability and financial performance.

Regarding stakeholder relations, Dallas (2006) stresses that this issue is on the 'radar screen' as one of twelve components to Standard & Poor's corporate governance analysis, even though there is no specific social mandate in the approach of many 'mainstream' investment institutions. For Standard & Poor's, the central issue in this regard is how stakeholder issues affect risk. This raises a series of questions which companies and investors should be asking, such as, what are the key strategic risks for companies in their stakeholder relations? Are companies aware of them? If so, what are they doing to manage these risks? It is now becoming generally acknowledged that maximising shareholder returns might be challenged if companies do not take stakeholder relations seriously. Long-term value is clearly affected by the way in which companies manage and relate to their non-financial as well as their financial stakeholders. This is an example of the ways in which investors and companies should be focusing on long-term strategy in corporate governance, rather than simply compliance and 'box ticking', reflecting the sentiments expressed by Butler (2007).

Although there is some indication that stakeholder inclusivity has become embedded in corporate governance, the link between corporate social responsibility and corporate governance is not necessarily

reflected in policy. Delsaux (2007) emphasises that the European Commission approached corporate social responsibility and stakeholder accountability as a separate issue from corporate governance. Indeed, he stressed that the EU's approach to corporate governance does not incorporate stakeholder-related issues. Clearly, the European Commission has focused on corporate social responsibility (for example, the Green Paper, European Commission 2001) but has treated it separately from corporate governance. The EU is significantly involved in encouraging stakeholder inclusivity. For example, the EU *Accounts Modernisation Directive* states that companies have to report on stakeholder issues. Delsaux considered that corporate social responsibility is an issue specifically relating to individual companies and the market in general, but that it should not necessarily fall under the corporate governance remit. In this way, the EU seems to adopt a traditional, finance perspective on corporate governance, which is narrow and shareholder-centric.¹⁰

However, the approach of the EU is to treat stakeholder accountability as a separate issue from corporate governance. There have not, to date, been moves to embed stakeholder inclusivity and social responsibility into the EU corporate governance agenda.

Dialogue between companies and their non-shareholding stakeholders has started to evolve in recent years, with companies instituting strategies, such as stakeholder engagement programmes. The review of UK company law, which led to the Companies Act 2006 has stressed that companies should take account of the needs of their non-shareholding stakeholder groups. Institutional investors are also becoming increasingly aware of the importance of integrating stakeholder concerns into their investment analysis and strategy. The field of socially responsible investment (SRI) has shifted from a marginal activity involving small-scale dedicated ethical investment funds to a mainstream institutional investment activity, as we shall see in the following section.

Thomson (2006) presents a theoretic framework for 'Enabling Effective Stakeholder Engagement: Learning from Theory and Practice', based on his academic publications in the area. Thomson drew on Freire's (2004) writings on pedagogy, which stipulate that education falls into two forms, namely those of 'banking' education and of 'dialogic' education. Banking education is education which involves delivering information to the student in a didactic, uni-directional manner. This is seen in a negative light from the perspective of encouraging critical thought and debate. On the other hand, dialogic education involves a process of two-way dialogue between the 'teacher' and 'student'. In this sense, it removes the authoritarian role of the instructor, allowing a genuine dialogue to develop and encouraging engagement and critical discussion. There is scope for applying the concept of dialogic education to other areas, such as corporate reporting.

10 This reflects also the approach adopted by *The Combined Code on Corporate Governance* (FRC 2006).

By forging an analogy between pedagogic methods and corporate reporting to, and engagement with, stakeholders, Thomson shows that companies should adopt a dialogic approach to information dissemination. Dialogic information dissemination involves engaging directly with the receivers of the information, rather than simply delivering the disclosures to them in a didactic manner. The nature of dialogic engagement, as opposed to 'banking' engagement, possesses a series of desirable characteristics. In dialogic engagement, stakeholders are assumed to possess valuable expertise, rather than being treated as ignorant and uninformed. Secondly, there is an assumed balance of power between organisations and their stakeholders, where engagement is dialogic, as opposed to a situation where organisations view themselves as experts providing one-way instruction. Third, the content and media of the engagement are mutually negotiated when engagements are dialogic, rather than being defined by the organisation. A fourth characteristic of dialogic engagement is that it is a system based on mutually informed critique rather than a 'banking' system, where there is limited opportunity for stakeholders to question or comment on the information received. Last, but not least, dialogic engagement between companies and their stakeholders should be effective in engendering change in actions and behaviour. Where engagements are not dialogic, there may be short-term suppression by the companies and the engagement is ineffective in bringing about change.

The overall message of Thomson's (2006) framework is that effective change in corporate behaviour and corporate governance can only be brought about where engagement processes with stakeholders are dialogic in nature.¹¹ This theoretical model provides a useful frame of reference for analysing the extent to which shareholder and stakeholder relations are acting as mechanisms for change. In other words, to what extent are the engagements between companies and their shareholders and non-financial stakeholders genuinely dialogic? Are they becoming bi-directional exchanges of information, which are leading to greater transparency and improved governance structures? Are shareholder and stakeholder relations actually contributing to more accountable corporations, which welcome the needs of their stakeholders and incorporate them into business practice?

11 Solomon and Darby (2005) apply this framework to the private disclosure of social and environmental information by companies to their institutional investors. They show that there is some empirical evidence that these disclosures are gradually becoming dialogic in nature, but that genuine stakeholder involvement in the process is perfunctory.

3.9 SOCIALLY RESPONSIBLE INVESTMENT: INVESTMENT WITH A FUTURE?

In his presentation *Socially Responsible Investment: Investment with a Future?*, Richard Stathers (2006) from Schroders outlines current issues in socially responsible investment (SRI) and made some predictions about the future growth of the SRI industry. He begins by identifying the main forms of shareholder advocacy in the SRI arena. Traditionally, the primary strategy employed by ethical investors was screening. Screening involves investment institutions 'screening' companies according to socially responsible criteria. Investors can screen positively or negatively (Solomon and Solomon 2004), where positive screening involves investing in companies which make an ethical addition to the investment portfolio. Negative screening involves fund managers avoiding companies that pursue 'unethical' activities. More recently, a less stringent approach has evolved known as 'best in sector'. This involves investors replacing a strategy of screening out certain 'unethical' sectors by a strategy of including those companies in each sector which are making the 'best effort' to perform in the social and environmental areas.

Replacing screening with a best in sector approach has made SRI more practical for institutional investors generally, and more popular. Stathers explains that SRI has grown significantly in recent years, not just in the UK but globally. For example, the Australian SRI retail market has witnessed a growth of 6,400% since 2001. There are a variety of SRI mechanisms being implemented by investment institutions around the world, which differ among countries. For example, the US approach to shareholder advocacy is to hold shareholder resolutions. This is an uncommon mechanism in the UK, with institutional investors relying more on engagement strategies and voting policies.

One of the main drivers of SRI has been the amendment to UK pension fund legislation, designed to promote greater awareness and consideration of social and environmental issues in institutional investment. Since July 2000, all private occupational pension schemes in the UK have been subject to new pension fund regulation. An amendment to pension fund law required all trustees to disclose the extent to which (if at all) they take account of SRI criteria in their pension funds. Many thought it likely that this requirement to disclose whether or not pension funds adopt an SRI policy would act as an incentive for trustees to adopt a policy, for example,

This [the new disclosure requirement] affects several hundred billion pounds of pension assets and is likely to cause a number of major pension funds to require their fund managers to give much greater emphasis to these issues (ACCA 2000: 7).

This UK amendment to pension fund law was imitated in a variety of ways by countries throughout Europe and elsewhere. Freshfields Bruckhaus Deringer (2005) says that pension fund trustees could be in breach of their fiduciary duty if they do not take into consideration

environmental, social and governance factors. Indeed, Stathers (2006) considered that the UK statement was weak in relation to those changes in law produced for other European economies.

Solomon and Solomon (2006) suggests that social, ethical and environmental issues were starting to have an impact on companies and investors, and that SRI improved investment performance over the long term. As a consequence they state that trustees would be in breach of their fiduciary duties if they did *not* pursue an SRI. This view has been reinforced by the findings of a new report released at the United Nations Environment Programme Initiative. The report, *A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment* (Freshfields Bruckhaus Deringer 2005) has been deemed extremely significant (Baue 2005). The report confirms that not only is it permissible for pension funds to consider social, environmental and governance factors, but in fact fiduciary duty requires that they be considered where there is potential for material financial impact from those factors. As an illustration, pension fund trustees should be considering climate change issues, such as carbon emissions, in their asset allocation and selection decisions. If they do not take account of these factors they are excluding issues which have potentially serious financial impacts on companies and their shareholders, as well as on society generally.

Stathers (2006) also discussed the work of the Carbon Emissions Investment Project, which is now challenging companies to disclose information on greenhouse gas emissions. Other initiatives driving the growth of SRI include the Just Pensions Responsible Investment Toolkit, the work of National Social Investment Fora, the World Business Council for Sustainable Development, the UN Global Compact and the Global Reporting Initiative. These initiatives are presenting a broad challenge to the institutional investment industry to engage on social, ethical and environmental issues. Indeed, three of the speakers, Mallin (2006), Melvin (2006) and Stathers (2006) emphasize the importance of the Association of British Insurers' (ABI) *Disclosure Guidelines on Socially Responsible Investment* (ABI 2001). Indeed, Melvin was one of the primary authors of this document. It is one of the first documents which urges directors to report publicly on social and environmental issues and which challenges them to integrate these issues into their everyday business operations.

Stathers (2006) makes general predictions about the future of SRI, centred around a continuing decline in the use of screening in investment decisions and a gradual rise in the best in sector approach. He considers that shareholder advocacy would continue to grow in the social, ethical and environmental areas, with greater levels of engagement and dialogue on these issues. He also predicts that SRI will move into the areas of property and fixed income investment. As SRI continues to become more firmly established, there will be a growing call for greater availability of detailed analysis and information on social and environmental issues and impacts.

3.10 SHAREHOLDER RIGHTS AND MARKET WRONGS

Wilson (2006) discusses the way in which the market is acting as a constraint on corporate governance reform. In the dialogic theoretical framework, she positioned Manifest as an 'issue amplifier', raising awareness and giving warning signals of corporate governance problems. Manifest has been in existence for a decade and its role is to provide information to decision makers and interested parties on the governance practices of listed companies. Notably, Manifest does not make voting recommendations, preferring to provide information to investors, so that they are armed with the necessary data to make decisions for themselves.

The overriding message from Wilson's (2006) presentation is one of caution, as she indicates that there is a big discrepancy between what is being said in terms of corporate governance improvements, and what is actually being done. Despite ample lip-service being paid to improvements in reporting by companies and overall transparency, there is a dearth of genuine information being provided to investors. In addition to annual reports, timely and decision-useful information is not being disclosed via websites or other media. Corporate governance has certainly improved but in terms of transparency and accountability to shareholders, as well as non-financial stakeholders, there has been little genuine shift in attitude and behaviour. From Wilson's view, it seems that at the heart of the corporate governance debate is the issue of transparency.

4. Conclusions and an agenda for future research

It is tempting to believe that the strong corporate governance architecture upon which Cadbury and its successors were founded in the UK needs little improvement. The UK can indeed be proud of the fact that the Cadbury report has been used as an inspiration for the development of hundreds of codes of best practice in corporate governance across the world. Given the UK's extensive efforts since 1992 in developing policy documents and best practice guidelines, it could be argued that the corporate governance machine is operating well and requires only minor tinkering and the occasional service. However, a close analysis of the operation of this machine, and of the various corporate governance mechanisms, raises far more questions than solutions.

In terms of shareholder and stakeholder relations, the impression given by the institutional investment community may not be as rosy as it first appears. It is certainly not a time for UK policy-makers and practitioners to rest on their laurels. Despite the recent flood of rhetoric about the improvements in dialogue and communication between institutional investors and their investee companies in both the practitioner and academic spheres, the speakers at both symposia suggested that institutional investors are not delivering what they purport to be delivering.

The need for further reform in corporate governance and avoidance of complacency is by no means restricted to the UK. Although codes of practice have burgeoned in countries around the world, the extent to which their impact has been taken up in spirit, rather than in letter, needs to be assessed. The EU has made significant strides in improving the corporate governance of its members. Adopting an EU-wide approach of comply or explain has helped to define the path for corporate governance reform in member states. Developing economies have also expended significant time and effort in developing codes of practice, and this needs to be accompanied by a focus on ethical behaviour and on genuine change in corporate culture.

4.1 THEMES IDENTIFIED

The presentations at the two symposia held at ACCA's London offices in February 2006 and May 2007 converged on a number of themes which appear to be at the 'cutting edge' of corporate governance. There was a general feeling that corporate governance initiatives were focusing on the 'wrong' areas, and that although significant progress had been made to reform corporate governance both nationally and internationally, substantial work remained to be done. The 'cutting-edge' themes arising from the symposia were issues relating to:

- shareholders' rights
- engagement and dialogue by institutional investors
- importance of shareholder dialogue as a tool for holding boards to account

- audit
- corporate governance in the EU
- corporate governance in developing economies
- stakeholder accountability.

The specific issues are covered in detail throughout the paper, but the overriding concerns arising from the presentations were that there should be a far greater focus on several themes which represent significant risk factors in corporate governance.

4.2 MAIN AREAS OF CONCERN

First, audit was perceived as a serious cause for concern. Speakers felt that audits were being rushed and that the impact of changes in auditors' liability was uncertain.

Secondly, stakeholder accountability was now perceived to be essential to 'good' corporate governance. The reputational risks associated with poor corporate social responsibility were viewed as substantial and both the corporate and the institutional investor communities should be adopting a stakeholder-inclusive approach.

Thirdly, shareholder rights, particularly voting rights, required attention, especially throughout the EU. Issues such as voting rights were sensitive in insider-type corporate governance systems where founding family members wished to retain control over companies. Dealing with these issues delicately was viewed as complicated and represented a significant challenge for policy makers.

Fourthly, stakeholder engagement was emphasised as an effective means of holding boards to account, and speakers mentioned a whole host of ways in which engagement could be improved and refined. New evidence is emerging which demonstrates a positive link between active engagement and financial performance.

Fifthly, corporate governance in developing economies required far more focus not on codes of practice but on encouraging companies and market participants to adopt corporate governance best practice in spirit. Connected to this was a need for issues of ethics to be forced into the spotlight, especially the concept of a universal code of ethics for business. The following section suggests a series of research questions which may be addressed in order to follow up these crucial corporate governance themes.

4.3 DIRECTIONS FOR FUTURE RESEARCH

It is essential to create a direct link between the academic and practitioner spheres in order to maximise the use of research resources, as well as ensuring the impact of research studies. It is especially important to find ways of operationalising theoretical models and of implementing the findings of academic research. If this does not happen effectively, then a large resource, namely university-led academic research, will fail to have an impact on policy,

leading to sub-optimal use of funding resources. This is particularly the case in a discipline as practice-oriented and alive as corporate governance and accountability.

It seems there is a call for further work into relations between companies and their institutional investors and non-financial stakeholders. The extent to which engagements between these parties are genuinely dialogic and therefore potentially effective in engendering change needs to be assessed against empirical evidence. Interview research and case studies across large samples of companies, in the UK and abroad, are effective ways of making this assessment. Further, detailed content analysis of corporate disclosures and their usefulness to shareholders and stakeholders remains to be done, especially in the social and environmental area at an international level.

Work is required to assess whether global collaboration by institutional investors would actually lead to a more transparent investment environment, and to greater stakeholder accountability by listed companies. Similarly, the extent to which there are constraints on the growth of SRI needs further research.

Another related topic is whether institutional investors are in practice prepared to provide greater accountability to their clients, in order to reduce some of the conflict apparent in the complicated ownership structure, especially in relation to pension funds. For example, the potential for improved disclosures by investment institutions to the beneficiaries of the funds, the real shareholders, needs to be researched. What obstacles hinder such disclosures? Are institutional investors prepared to develop disclosures in this way?

Overall, there are far more questions than there are solutions. Innovative governance mechanisms need to be provided from informed research, in order to improve accountability and transparency in the relations between companies and their shareholders and stakeholders. Arguably what is required is research to highlight ways in which corporate governance can be improved in spirit. In order for practicable and logical solutions to be offered, far more research needs to be done, with greater linkages being created between academics and practitioners working in corporate governance.

In relation specifically to the themes arising from the presentations at the two symposia, the following research questions have been identified.

4.4 SHAREHOLDER RIGHTS

How can traditional, family-run/controlled listed companies be persuaded to accept changes in voting rights?

What are the attitudes of company directors in EU member states towards changing voting rights?

In light of the European Commission's decision not to legislate on the one-share: one-vote principle, how can the potential conflict in the interests of institutional shareholders and founding family shareholders be satisfactorily resolved?

Generally, what are the differential attitudes of founding family shareholders towards corporate governance reform across EU countries?

Is there scope for a Myners-type detailed review of impediments to voting across the EU?

4.5 INSTITUTIONAL INVESTORS: ENGAGEMENT AND DIALOGUE

Could we build on the 'Tomorrow's Company' Report (2004) to investigate ways of rebuilding trust in financial institutions?

How could institutional investors improve their own governance structures? (Disclosures, for example?)

Could there be further research into whether engagement adds value? (Using different samples/time periods/country data?)

How can relationship investors achieve a better balance between structural and strategic governance?

How can corporate governance attention be made to focus more on strategic issues relative to compliance?

How successful is collaborative shareholder activism at an international level? Is it adding value?

How can institutional investors be more accountable to their beneficiaries?

4.6 AUDIT

How deeply rooted in the financial community is the concern about audit?

Should there be further changes to auditors' liability?

What views do professional indemnity insurers have on the consequences of changes to auditors' liability?

Do underwriters consider that reducing auditors' liability decreases or increases risk, and how would this affect risk premiums?

How can trust in audit quality be rebuilt?

How can corporate governance initiatives be refocused on the audit function?

Is there a need/demand for auditors to provide longer reports – such as on the scope of audit and/or on verifying governance disclosures?

What is the ability of the audit profession and financial reporting to form a useful judgement on complex transactions such as attributing values to assets where there is no ready market?

What is the ability of the financial reporting and auditing process to inform users of accounts of the risks associated with such judgements?

4.7 CORPORATE GOVERNANCE IN THE EUROPEAN UNION

Is the comply or explain approach appropriate for all EU member states, which are so diverse in ownership structure, inter alia?

Is the 'one size does not fit all' caption an excuse for not developing a Europe-wide set of principles?

Why can't the EU have a set of principles, when the OECD has produced one for countries that are far more diverse? Is there a potential for an EU-wide code of best corporate governance practice?

How could the European Commission's sanctions for non-compliance be strengthened?

What is the consensus on an EU-wide language for accounts and documentation?

How can EU companies be 'forced' to have genuinely independent non-executive directors (NEDs)?

What are the minimum standards that SMEs could be expected to adopt?

4.8 CORPORATE GOVERNANCE IN DEVELOPING ECONOMIES

How can the structural and cultural impediments to corporate governance reform be reduced and/or removed?

How can companies in developing countries be persuaded to take on corporate governance principles in spirit?

How can shareholder rights be improved?

What do different countries understand by 'ethics'?

How can we achieve a consensus on ethics which will act as a universal basis for corporate governance reform?

How do we achieve an internationally acceptable understanding of ethics?

4.9 STAKEHOLDER ACCOUNTABILITY

Are stakeholder engagement programmes and sustainability reporting enough as ways for business to discharge their accountability to stakeholders?

What new corporate governance mechanisms for enhancing stakeholder inclusivity can be developed? (eg stakeholder advisory panels, NED championing stakeholder interests, stakeholder inclusivity on board, broadening NED diversity – Tyson report, brushed under the carpet).

To what extent is stakeholder inclusivity becoming integral to the assurance of sustainability reports?

Why does the European Commission not include stakeholder accountability in its corporate governance remit when the OECD and the British Commonwealth do?

It is clear that many of the issues identified through these research questions, and which require attention, are sensitive in nature – which is probably why they have not been adequately addressed. For example, voting rights in some EU countries and developing economies represent a sensitive issue, as do language issues in accounting and documentation, independence of NEDs in some countries, and cultural, political, bribery and corruption impediments to corporate governance reform in developing economies. Similarly, issues relating to stakeholder inclusivity, climate change and human rights can be sensitive for companies and their stakeholder groups. Adopting an ethical approach can help to deal with sensitive, controversial issues and conflicts of interest.

It is also apparent that addressing many of the 'cutting-edge' issues are essential for risk management. The startling emphasis on a lack of confidence in audit, and its perception as a 'time bomb' requires urgent attention. Stakeholder accountability represents a significant reputation risk for companies and for institutional investors. Further, far more corporate governance mechanisms need to be developed to enhance stakeholder accountability. Reliance solely on sustainability reporting and stakeholder engagement is insufficient.

Overall, to progress the corporate governance agenda further, there need to be stronger links forged between corporate governance research in the academic and practitioner spheres. The experiences of other countries appear to involve a greater connection between academic research and government policy. Academic work should be informing policy and practitioners should be informing academic research more closely. Hopefully, initiatives such as the British Accounting Association Corporate Governance Special Interest Group can help to forge links between academics and practitioners.

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- Wilson, S. (2007), 'A Manifest Investigation into the Practical Problems of Informed Voting Across EU Borders', presentation at the British Accounting Association Corporate Governance Special Interest Group Symposium on Future Directions in Corporate Governance, Cardiff University, May.

Appendix 1: List of speakers

SPEAKERS AT THE SYMPOSIUM, FEBRUARY 2006 'SHAREHOLDER AND STAKEHOLDER RELATIONS'

George Dallas, managing director and global practice leader, Governance Services, Standard & Poor's

Christine Mallin, professor of corporate governance and finance, Birmingham University

Colin Melvin, director of corporate governance, Hermes Pensions Management Ltd

Richard Stathers, socially responsible investment specialist, Schroders Investment Management Ltd

Ian Thomson, senior lecturer, Strathclyde University

Sarah Wilson, managing director, Manifest Information Services Ltd

SPEAKERS AT THE SYMPOSIUM, MAY 2007 'FUTURE DIRECTIONS IN INTERNATIONAL CORPORATE GOVERNANCE'

Peter Butler, founder partner and CEO, Governance for Owners

Brian Cheffins, S. J. Berwin professor of corporate law, Faculty of Law, Cambridge University

Pierre Delsaux, European Commission

Anne Simpson, executive director, ICGN

Simeon Wanyama, Uganda Martyrs University

Sarah Wilson, managing director, Manifest Information Services Ltd

Appendix 2: Biographies

SPEAKERS' BIOGRAPHIES

Peter Butler

Peter is a founder partner and chief executive of Governance for Owners (GO), an independent partnership between major financial institutions, shareholders and executives dedicated to adding long-term value for clients by exercising owners' rights. Prior to this, Peter was CEO of Hermes Focus Asset Management for six years, responsible for building the highly respected Corporate Focus and Focus Fund teams. Before joining Hermes, Peter had over 20 years' global experience in a wide range of industries as a senior executive, including seven years as a director of quoted companies. Peter is a governance protagonist and frequently participates in seminars and conferences worldwide.

Brian R. Cheffins

Brian is S.J. Berwin professor of corporate law at the Faculty of Law University of Cambridge. Before going to Cambridge, he taught at the University of British Columbia's Faculty of Law. He has held visiting appointments at Duke, Harvard, Oxford and Stanford Universities and is a Fellow of the European Corporate Governance Institute. Brian is the author of *Company Law: Theory, Structure and Operation* (Oxford 1997; co-winner, Society of Public Teachers of Law Prize for Outstanding Legal Scholarship), *The Trajectory of Corporate Law Scholarship* (Cambridge 2004) and numerous articles on corporate law and corporate governance.

George S. Dallas

At the time of speaking George was managing director and global practice leader for corporate governance at Standard & Poor's. Based in London, George has led Standard & Poor's global corporate governance initiative since the late 1990s, and has been actively involved in developing an analytical approach to corporate governance and with developing corporate governance evaluations on individual companies in mature and emerging markets around the world. George is also actively engaged with Standard & Poor's wider enhanced analytics initiative – linking corporate governance evaluations more formally to the credit rating process. Prior to this assignment he was head of global emerging markets for Standard & Poor's. He also has served as regional head for Standard & Poor's ratings services in Europe and has been head of Standard & Poor's London office and practice leader of the company's international corporate ratings group. He joined Standard & Poor's as an analyst in 1983, prior to which he was a corporate lending officer at Wells Fargo Bank. He was the editor of the book *Governance and Risk* (McGraw Hill 2004), and has written numerous articles and several book chapters on themes relating to corporate governance and international finance. He is a member of the European Corporate Governance Institute and the International Corporate Governance Network. He is also a member of the advisory board of the Duke University Global Capital Markets Center and has served on the boards of Standard & Poor's affiliates in France and Spain. He is a member of the Global Reporting Initiative's Investor Consultation Group and is also a member of the United Nations

Environment Programme's expert group on Responsible Investing. In 2003, he won the McGraw-Hill award for Excellence in Leadership. Mr. Dallas holds a BA, With Distinction, from Stanford University and an MBA from the Haas School of the University of California at Berkeley. He has dual nationality in the US and the UK. He speaks German and French, and has a working knowledge of Russian. He is now a director at F&C Management Ltd.

Christine Mallin

Christine is professor of corporate governance and finance, and the founder and director of the Centre for Corporate Governance Research, at Birmingham Business School, the University of Birmingham, UK. She is a chartered accountant and worked for Peat Marwick Mitchell (now KPMG) and Binder Hamlyn (now Deloitte). She has a PhD in finance awarded by the University of Nottingham. She lectured in the private sector and subsequently held lecturing posts at the University of Nottingham and at Warwick Business School, where she was an ICAEW Academic Fellow from 1992–1995. She was the Rapporteur on the Independent Inquiry established by the National Association of Pension Funds (NAPF) on 'UK Vote Execution'. She is a member of the International Corporate Governance Network (ICGN) and has been on two of the ICGN's working parties established to draft guidelines on international corporate governance principles, and on global voting. She is a member of the ICGN Cross-Border Voting Practices Committee, and a member of the UK's Shareholder Voting Working Group chaired by Paul Myners. She is also a member of the Canada–Russia Corporate Governance Program Advisory Council; an advisory group member of the Japan Corporate Governance Research Institute; and a member of the Academic Advisory Board of the Centre for Research in Public & Private Governance, Universidad del CEMA, Buenos Aires, Argentina. She was a director from 2000 to 2006, and chair of the Audit and Risk Management Committee, of the Aston Reinvestment Trust (chaired by Sir Adrian Cadbury) which was launched in 1997 as a pioneer of social investment and which has become the leading local community finance initiative in the UK. From 2000 to 2007, she was the Editor of *Corporate Governance: An International Review*, an internationally recognised journal which is included in the ISI Social Sciences Citation Index. She has published widely on corporate governance issues, both in academic and professional journals, and has been invited to present her research at many conferences in the UK and overseas, as both academic and practitioner. The second edition of her book *Corporate Governance* was published by Oxford University Press in December 2007.

Colin Melvin

Colin is director of corporate governance, Hermes Investment Management, and CEO of Hermes Equity Ownership Services. Colin is responsible for the direction, development and management of corporate governance and socially responsible investment in relation to Hermes' equity shareholdings, directing the largest corporate governance resource of any fund management company. He is also the CEO of Hermes Equity Ownership Service, which provides corporate governance, voting and engagement assistance to pension funds on assets managed by third-party fund managers. Colin is currently an active member of various industry steering groups and committees, including those of the United Nations Project on Principles for Responsible Investment, the Work Foundation Panel of Inquiry into Work and Enterprise and the Global Institutional Governance Network. He also chaired the organising committee for the International Corporate Governance Network's 2005 annual conference, which attracted over 500 attendees from 37 countries. He is currently a member of the ICGN's standing committees on executive remuneration and cross-border voting. He has also founded or led various investor groups, including the Performance Pay Group and SRI Forum in the UK and co-drafted guidelines for corporate disclosure on social, environmental and ethical matters, which have been issued by the Association of British Insurers. In November 2001, he set up the Responsible Investors Network, to facilitate the development of corporate engagement in this area. Previously, Colin was corporate governance manager and Secretary to the Ethics Committee at Standard Life Investments. He is also a former member of the Advisory Board to Aberforth Limited Partnership I, a fund engaged in relational and active-value investing. Colin joined Hermes in 2002 and became CEO of Hermes Equity Ownership Services in 2005. He is an associate member of the Chartered Financial Analysts Institute and the UK Society of Investment Professionals. He holds an MA from Aberdeen University and an MPhil from Cambridge University, both in History, and a Diploma in Investment Analysis from Stirling University.

Anne Simpson

Anne is executive director of the International Corporate Governance Network, whose members are drawn from over 30 countries worldwide, and include investors responsible for US\$10 trillion in global assets (www.icgn.org). Prior to this she was head of the secretariat at the Global Corporate Governance Forum, founded by the World Bank and OECD to support reform in developing and emerging markets, with programmes in Latin America, East and South Asia, Africa, the Middle East, Russia and Eastern Europe (www.gcgf.org). The Forum sponsored private-sector dialogue and policy development, academic research and director training in a wide range of markets. Before being recruited to the World Bank, initially on secondment in 1998, she was for more than 10 years joint managing director of Pensions & Investment Research Consultants Ltd, Europe's leading independent investment advisors on corporate governance and corporate responsibility to institutional shareholders with assets of over €700 billion (www.pirc.co.uk).

Simeon Wanyama

Relevant studies: MBA in Controllershship (St. John's University, New York, 1991); PhD (University of Dundee, 2006): Research topic: *Corporate Governance and Accountability in Uganda: An Analysis of Stakeholder Perspectives*. Member of ACCA. Current position: deputy vice-chancellor, Uganda Martyrs University. Previous positions held: dean of the Faculty of Business Administration and Management, Uganda Martyrs University; finance director, Archdiocese of Tororo, Uganda, development coordinator, Archdiocese of Tororo; principal, St. Paul's College, Mbale, Uganda; chairman, Advisory Board, Centenary Rural Development Bank, Mbale Branch, Uganda.

Sarah Wilson

Sarah is the founder and managing director of Manifest Information Services Ltd, which was established in December 1995 to provide high-quality proxy voting and governance research support services to institutional investors and professional advisors. Sarah's first position was in publishing as a researcher for the business magazines division of Haymarket Publishing, where she worked with Simon Caulkin, now business editor of the *Observer*. In 1982 she moved into the City, starting at Datastream, the UK's first online data vendor. In 1988 she moved into stock-broking, specialising in independent research sales. After leaving James Capel in 1994 Sarah developed the business plan for Manifest, secured VC funding and launched the first online proxy voting agency in the UK in the spring of 1996. Manifest now employs 25 staff and has a variety of clients, ranging from local government pension schemes, institutional investors, academics, professional advisors and HM Government. Sarah has served on a variety of committees, including the Information Providers User Group, International Corporate Governance Network, DTI Governance Forum and the Council of Institutional Investors. She is a regular speaker at industry events and has made numerous appearances on BBC TV and radio, Bloomberg TV and CNBC. Sarah lives in Witham, Essex with her husband, Tim, also IT director of Manifest, two teenage children and four cats. Leisure pursuits are focused on Witham's community theatre in front and back-stage roles and she is business manager of Witham's youth theatre group.

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